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Supreme Court of the United States

OCTOBER TERM, 1932—No. 718

CONRAD, RUBIN & LESSER,

Petitioners,

against

HORACE G. PENDER,

Trustee in Bankruptcy.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF ON BEHALF OF PETITIONERS

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Supreme Court of the United States

CONRAD, RUBIN & LESSER, *Petitioners,* against HORACE G. PENDER, *Trustee in Bankruptcy.*	October Term, 1932 No. 718

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF ON BEHALF OF PETITIONERS

Opinions Delivered in Courts Below:

CAFFEY, *D. J.* (United States District Court, Southern District of New York) reported in 52 Fed. (2nd) 755.

SWAN, *C. J.* (Circuit Court of Appeals, Second Circuit) reported in 61 Fed. (2nd) 771.

Statement as to Jurisdiction.

This matter comes before this Court on a writ of certiorari to the Circuit Court of Appeals, Second Circuit, on a petition therefor filed on February 21st, 1933, and granted on March 27th, 1933. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, the decree to be reviewed being, under the Act of September 6, 1916, a final determination under the Bankruptcy Act, subject to review by certiorari. The decree of the Circuit Court of Appeals was filed on November 21, 1932.

Statement of the Case.

This proceeding involves the construction of Section 60 (d) of the Bankruptcy Act which reads as follows:

> "If the debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney and counselor at law, solicitor in equity, or proctor in admiralty for services to be rendered, the transaction shall be re-examined by the court on petition of the trustee or any creditor and shall only be held valid to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate."

The question presented, briefly stated, is: Has the Court jurisdiction to examine a fee paid to an attorney for a corporation, for services rendered in endeavoring to bring about a reorganization of the corporation and an adjustment with its creditors, where the corporation, not being insolvent, is nevertheless unable to meet its maturing obligations in cash, and an involuntary petition in bankruptcy is subsequently filed against it.

The Facts.

Petitioners are attorneys at law engaged in the practice of law in the City of New York (Record, p. 3). The respondent is trustee in bankruptcy of David Bell Scarves, Inc., a New York corporation (Record, p. 3).

On October 31st, 1930, William W. Conrad, one of the petitioners, was consulted by David Bell, an officer of the corporation, with respect to its financial condition (Record, p. 8). Mr. Bell brought with him the balance sheet of the corporation as of the last day of the preceding month, a copy of which is found in the record at page 11.

The balance sheet showed that the corporation had net assets of approximately $65,000.00, of which about $6,000.00 was cash, $19,000.00 accounts receivable, $24,000.00 merchandise, and $15,000.00 in machinery and fixtures, after deduction for depreciation. Its liabilities comprised about $45,000.00 in accounts payable, slightly less than $5,000.00 in notes payable and about $3,000.00 in miscellaneous obligations, bringing the total liabilities to approximately $53,000.00. (We have, for the sake of convenience, used round figures instead of the precise figures set forth in the Record [p. 11].) The balance sheet further showed that there had been an operating loss of some $24,000.00 during the preceding six months period which had wiped out the previously existing surplus and had substantially impaired the capital. *The accuracy of this balance sheet has never been questioned.* It clearly indicates a *solvent,* although *unliquid,* condition. The inability to meet the corporation's maturing obligations was obviously because of the fact that a substantial part of its assets were not readily convertible into cash.

Under these circumstances petitioners were retained by the corporation to conduct such negotiations as might be necessary with its creditors and trade associations to arrange for an extension of time and, if necessary, for the operation of the business under the supervision of its creditors to the end that the business might be continued without the necessity of forced liquidation and might ultimately be restored to a sound basis (Record, p. 8). This the petitioners undertook to do for a fee of $2,500.00 which was paid to them on November 3rd, 1930 (Record, p. 9).

During the period between October 31st, 1930, and November 17th, 1930, Mr. Conrad, one of the petitioners' firm, was in practically continuous conferences with creditors and trade associations, some of which lasted until late hours of the evening (Record, p. 27). As a result of these negotia-

tions a creditors' committee was formed (Record, p. 32). The committee was, from the inception, fully informed of the fees paid to petitioners (Record, p. 33) and of petitioners' plans with respect to the reorganization of the corporation (Record, p. 29).

Although it was then contemplated that the business be continued under the supervision of the creditors' committee, or a representative of the New York Credit Adjustment Bureau (Record, p. 9), it developed in the course of the negotiations that the committee would recommend a cash settlement of 50% (Record, p. 33), rather than a protracted extension, and petitioners thereupon proceeded to procure funds for the purpose of effectuating such settlement by hypothecating the corporation's accounts receivable (Record, p. 29).

After the foregoing arrangements had been worked out, and on November 17, 1930, three creditors saw fit to file an involuntary petition in bankruptcy against the corporation and on the same day, a receiver was appointed (Record, p. 5). The receiver immediately qualified and took possession of the corporation's assets (Record, p. 5) and proceeded immediately to liquidate them by sale in bankruptcy. An order of adjudication in bankruptcy was entered on November 21, 1930 (Record, p. 4).

The receiver's report indicates that the net amount realized upon the assets sold by the receiver was $19,475.35 (Record, p. 35). That figure, of course, represents the proceeds of a forced sale of merchandise, machinery and fixtures and cannot reflect their true value as part of the assets of a going concern.

The services rendered by petitioners being aimed at the rehabilitation of the business and not its liquidation, either in bankruptcy or otherwise, such value as they may have had was destroyed by the filing of the petition in bankruptcy. The act of a small group of creditors compelled the forced

liquidation of the corporation's business under circumstances which would enable only a small fraction of its value to be realized to the detriment both of the corporation and of its creditors. In the bankruptcy proceedings a dividend of 16⅔% was declared on March 12, 1931 (Record, p. 24) with the likelihood, after deduction of administration expenses, of a small additional dividend.

Upon the appointment of a trustee in bankruptcy, proceedings were commenced against petitioners under Section 60 (d) of the Bankruptcy Act to re-examine the payment of the fee received by petitioners in connection with the efforts to bring about a reorganization of the corporation.

Upon a hearing before the referee, objection was made by petitioners to the Court's jurisdiction upon the grounds (a) that the payment to petitioners was not made in contemplation of the filing of a petition in bankruptcy by or against the corporation; and (b) that the services which petitioners were engaged to render were not those which came within the purview of Section 60 (d) of the Bankruptcy Act (Record, p. 8). The referee overruled the objections to his jurisdiction and directed the taking of testimony as to the value of petitioners' services (Record, p. 12). The petitioners, however, stood upon their jurisdictional objection and declined to submit testimony as to the value of their services (Record, p. 16). Petitioners consistently maintained that the nature of the services rendered by them, not being within the purview of the Bankruptcy Act and not being aimed toward the performance of the duties of a bankrupt, were not such as entitled petitioners to allowance out of the bankrupt estate under either Section 60 (d) or Section 64 (b) (3) and hence were not subject to re-examination in bankruptcy under the former section.

The trustee, upon rejection of petitioners' jurisdictional objection, proceeded to present, ex parte, evidence in support of his claim. No question was raised as to the facts above

set forth, the circumstances under which petitioners were retained being established by the affidavit of Mr. Conrad and his testimony previously taken in an examination under Section 21 (a) of the Bankruptcy Act. The claim that the corporation must have contemplated the filing of a petition in bankruptcy was sought to be supported by the fact that the subsequent forced liquidation by the receiver realized less than an amount sufficient to pay the creditors in full. It was also suggested that the withdrawal of various sums of money by two of the officers of the bankrupt for back salaries and the earlier payment of fees to another attorney tended to show such contemplation of bankruptcy. The referee, however, declined to permit the testimony of the officers of the bankrupt to be used (Record, p. 18) and hence no proof appears in the record of the consideration for which the various payments referred to were made. It may well be that all of the moneys received by officers of the corporation were subsequently returned to its treasury or used for purposes entirely proper.

The referee held that the services of petitioners were worth $500.00 and directed the repayment to the trustee of $2,000.00 (Order, Record, p. 37). Upon petition to review, this order was confirmed by the District Court and an opinion written by CAFFEY, *D. J.* (Record, p. 42). Leave was given to appeal to the Circuit Court of Appeals (Record, p. 2) and a decree was made affirming the order of the District Court (Record, p. 53), the opinion of the Circuit Court of Appeals being written by SWAN, *C. J.* (Record, p. 48).

Argument.

We contend:

(1) That where services are rendered by an attorney to a client, in good faith, and payment is made therefor by the client, the fact that a petition in bank-

ruptcy is subsequently filed against the client should not, of itself, under Section 60 (d) render such payment subject to summary re-examination.

(2) That the clause in Section 60 (d) "in contemplation of the filing of a petition by or against him" must be construed to mean the contemplation of actual bankruptcy proceedings and cannot be deemed to apply to every case of financial difficulty or embarrassment.

(3) That the provisions of Section 60 (d) and Section 64 (b) (3) are correlative and are intended to protect attorneys in the payment of fees in connection with bankruptcy proceedings for services rendered which are pertinent to the aims of the Bankruptcy Act as well as to protect creditors against the payment by the bankrupt, in advance of the filing of the petition, of excessive fees for services with respect to which the Bankruptcy Court should alone have jurisdiction.

(4) That our contentions are consistent with the decisions of this Court and that the determination of the Circuit Court of Appeals is inconsistent with those decisions and with the decisions in other Circuits.

POINT I.

Where services are rendered by an attorney to a client, in good faith, and payment is made therefor by the client, the fact that a petition in bankruptcy is subsequently filed against the client should not, of itself, under Section 60 (d) render such payment subject to summary re-examination.

The only limitation upon a debtor's right to engage counsel and pay for his services is found in the words "in contemplation of the filing of a petition by or against him." No provision is made with respect to any time within which

Section 60 (d) applies nor is it provided that a presumption of such contemplation will be deemed to exist where payment is made within any fixed time prior to actual bankruptcy. Conceivably a debtor might engage an attorney in actual contemplation of an inevitable bankruptcy proceeding which might not materialize for many months. It is conceivable similarly that a debtor might continue a normal business course until the very eve of the filing of a petition in bankruptcy against him without the slightest reason to contemplate that such proceedings are imminent. We do not contend that the state of mind of the debtor must always control; for a debtor might be blind to actual facts which in a reasonable person would necessarily raise a contemplation of bankruptcy. However, the mere fact of financial embarrassment in the sense that assets of a going concern are frozen and not available for the payment of maturing obligations does not create a situation which indicates the necessity or even the likelihood of bankruptcy proceedings. If such were the case, thousands of persons who today feel the stress of economic conditions should be charged with contemplation of bankruptcy in all of their acts in the normal course of their business.

It must be apparent that Congress could not have intended to single out, as subject to summary review, payments made to attorneys in the regular course of business, even where such services related to the financial condition of the client and involved efforts to relieve a strain upon the resources of the client. The payment of an attorney is usually a matter of contract between the parties. Can it be said that Congress intended to limit the right of an attorney and client, in good faith, to make arrangements mutually satisfactory to them merely because a subsequent unanticipated bankruptcy proceeding resulted from the acts of a small group of creditors?

The Bankruptcy Act makes ample provision for the protection of the rights of creditors in the event of fraudulent or preferential payments. Attorneys are not exempt from the operation of such provisions. Should any payment be made to an attorney without adequate consideration or in fraud of creditors, or with the purpose of creating a preference, remedies are available to the trustee to the same extent as where the transactions are with persons other than attorneys. There would seem to be no logical reason for assuming that Congress intended that Section 60 (d) should apply to any case other than one which came strictly within the meaning of the words "in contemplation of the filing of a petition by or against him."

In the present case can it be said either that the corporation must necessarily have contemplated bankruptcy or that its financial condition was such that it must be presumed to have contemplated the filing of a petition in bankruptcy against it? It is difficult to reconcile the condition of the business as indicated on its balance sheet (Record, p. 11) with any contemplation of bankruptcy proceedings. The fact that against the will of the corporation a petition in bankruptcy was subsequently filed and that a liquidation of its business in the manner provided for by the Bankruptcy Act realized an amount insufficient to pay its creditors in full, certainly does not justify the conclusion that actual insolvency existed. We venture to suggest that few going concerns could survive a forced liquidation of their assets without showing a deficiency.

It will be noted from the balance sheet of the corporation that close to $40,000.00 of its assets comprised merchandise, machinery and fixtures. The services which petitioners were retained to render were constructive in their nature. The value of these assets, largely destroyed by bankruptcy proceedings, would have been preserved for the benefit of the creditors and the corporation, had the pending reorganiza-

tion been carried out in accordance with the arrangement made with the creditors' committee. Had the corporation contemplated the possibility or likelihood of the filing of a petition in bankruptcy against it, no useful purpose could have been served by engaging counsel to bring about a reorganization of the corporation and an adjustment with its creditors. Can the ill-advised act of a small group of creditors and the results which flowed therefrom alter the situation which existed at the time petitioners were retained and rendered their services? Wisdom after the event certainly cannot be applied to conditions which existed at the time of the occurrences in question.

POINT II.

The clause in Section 60 (d) "in contemplation of the filing of a petition by or against him" must be construed to mean the contemplation of actual bankruptcy proceedings and cannot be deemed to apply to every case of financial difficulty or embarrassment.

Concededly the contemplation of bankruptcy refers to the state of mind of the debtor. The learned Circuit Court of Appeals suggests, in its opinion, that the imminency of bankruptcy must have been present in the thoughts of the officers of the corporation (Record, p. 53). Such conclusion is based upon the fact that the corporation and its attorneys discussed the possibility of an equity receivership to conserve the business in the event that an extension of time or other adjustment were not made with its creditors. We respectfully point out that even recourse to an equity proceeding was not contemplated by the parties but was merely a suggestion of a means to avoid a forced liquidation of a solvent business (Record, p. 9). It was the most extreme course discussed (Record, p. 9).

This Court had occasion to construe the words "in contemplation of bankruptcy" as used in Section 2 of the Bankruptcy Act of 1841 (5 Stat. at Large 442) which made invalid certain transfers and payments made "in contemplation of bankruptcy." Mr. Justice CURTIS, in *Buckingham* v. *McLean*, 13 Wall. 151, said (p. 168):

> "It is certainly true in point of fact, that even a merchant may contemplate insolvency and the breaking up of his business and yet not contemplate bankruptcy. He may confidently believe that his personal character and the state of his affairs, and the disposition of his creditors, are such that when they shall have examined into his condition they will extend the times of payment of their debts, and enable him to resume his business. A person, not a merchant, banker, etc., and consequently not liable to be proceeded against and made a bankrupt, though insolvent, may have come to a determination that he will not petition. The contemplation of one of these states, not being in fact the contemplation of the other, to say that both were included in a term which describes only one of them, would be a departure from sound principles of interpretation."

In the present case, it is not suggested, even by the trustee, that the corporation actually contemplated that a petition in bankruptcy would be filed against it. On the contrary, all of the services rendered by petitioners and the acts of the corporation by its officers were consistent only with the belief that no bankruptcy proceedings would ensue. The Act of 1841 used the term "in contemplation of bankruptcy," a more broad and general term than the words of Section 60 (d) of the Bankruptcy Act of 1898. The latter provision clearly applies not to a contemplation of a state of bankruptcy but to the actual filing of a petition in bankruptcy and the liquidation of the business in the Bankruptcy Court.

The courts in other Circuits, have, in a number of cases, held that in order to come within the meaning of Section 60 (d), something more than "consciousness of insolvency" is necessary.

In *Tripp* v. *Mitschrich*, 211 Fed. 424 (C. C. A., 8th Circ.) it appeared that within five days prior to the filing of an involuntary petition the bankrupt had employed an attorney to collect a fire loss. Prior to adjudication the attorney had settled with the insurance companies and retained his fee on a basis of 30%, in accordance with the terms of a written retainer. The trustee brought on a petition to re-examine the fee under Section 60 (d). It was held that the referee had no jurisdiction of the proceeding. POPE, *D. J.*, said (p. 427):

> "The words 'in contemplation of bankruptcy' refer to the state of mind of the debtor, not of the attorney. This results from even a casual reading of the section. But what is meant by contemplation? We are of opinion that as here used it means more than a simple consciousness of insolvency. * * * Contemplation thus means more than the knowledge that a bankruptcy proceeding either by or against the debtor is impending. It means that in making the transfer the debtor is influenced by the possibility or imminence of such a proceeding. There must be some relation as of cause and effect between knowledge of his condition and the transfer."

It is to be noted that the Court, in the *Tripp* case, called attention to the fact that in many of the cases where referees had been permitted to review and re-examine fees paid to attorneys prior to the filing of a petition in bankruptcy, the attorneys had appeared and submitted voluntarily to the jurisdiction of the referee. Accordingly, it was pointed out, many of the cases in which fees had been re-examined were not controlling on the question of jurisdiction, since such

question had not been raised. The Court said, in the *Tripp* case, after reviewing the earlier cases (p. 431):

> "But in none of these cases was the question one of jurisdiction. The crux of the controversy in each case was not whether the fee was reviewable but whether it was allowable. In each of these instances the attorney submitted his case to the Court on the merits and these expressions were in determining how far he was entitled to the protection of Section 60d. Were Mitschrich here submitting his case and asking the Court to declare how far his fee was allowable, instead of resisting jurisdiction, the case last quoted would be instructive. But that is not the situation."

Similarly, in *In re Geller*, 216 Fed. 558 (D. C. D. N. J.), it appeared that an attorney was engaged to conduct negotiations and adjust certain claims against insurance companies. The attorney collected moneys shortly before the filing of a petition in bankruptcy and withheld his fees. Upon application by the trustee to re-examine such fees under Section 60 (d), it was held that the referee was without jurisdiction, HAIGHT, *J.*, said (p. 562):

> "The fact that it might have occurred to the bankrupt, when he made the assignment, that proceedings in bankruptcy might thereafter be instituted either by or against him, and that the attorney to whom the collection of moneys was intrusted might deduct his fees therefrom, coupled with the fact that he afterwards attempted to do so, cannot be considered as a payment in contemplation of bankruptcy, such as is within the purview of Section 60d."

This Court had occasion to construe the provisions of Section 60 (d) in the case of *In re Wood and Henderson*, 210 U. S. 246. The question involved in that case was one of the manner of acquiring jurisdiction and of the method

of re-examination. In the course of the opinion of the Court, Mr. Justice DAY said (p. 253):

> "It (Section 60d) recognizes the right of such a debtor to have the aid and advice of counsel, and, *in contemplation of bankruptcy proceedings which shall strip him of his property,* to make provision for reasonable compensation to his counsel. * * *"

(P. 258):

> "This section in effect confers a special jurisdiction in a bankruptcy proceeding; it is only available when property has been transferred in contemplation of the filing of a petition in bankruptcy. *When the affairs of one about to be adjudicated a bankrupt are in that situation,* then the Act, recognizing the right of the bankrupt to legal services to be rendered, undertakes to prevent the diminution of the estate to be administered and distributed for the benefit of creditors beyond a fair provision for counsel under such circumstances." (Italics ours.)

Mr. Justice BREWER (in a dissenting opinion upon another phase of the matter) similarly said (p. 264):

> "While Section 60d is not in the Bankruptcy Act of 1867, obviously it was specially inserted in the present act for the purpose of making clear the liability of counsel receiving payment in advance. It is simply a declaration that an excessive prepayment to counsel *employed with a view to bankruptcy proceedings* is to be considered, so far as the excess is concerned, a preference and recoverable by the trustee in bankruptcy." (Italics ours.)

Although the foregoing language has been construed as giving a broad interpretation to the provisions of Section 60 (d), it is respectfully suggested that this Court did not, in the above case, intend to suggest that the language of

Section 60 (d) should be deemed to apply to any case other than one in which the debtor employs an attorney in definite and immediate contemplation of the filing of a petition in bankruptcy by or against him.

In *In re Porter,* 253 Fed. 552 (C. C. A., 7th Circ.) the Court, in a per curiam opinion, after reviewing evidence touching upon the payment of certain fees to an attorney, said:

> "We conclude that such evidence amply supports the referee's finding that the payment was made by the bankrupt out of his estate in contemplation of bankruptcy and was for services rendered or to be rendered such bankrupt in the matter of his bankruptcy proceedings."

The Court held that upon such finding an order could properly be made under Section 60 (d). An application to this Court for a writ of certiorari was denied.

Haneey v. *Taylor,* 248 U. S. 585.

It is apparent from the foregoing decision that on the theory adopted by the Circuit Court of Appeals of the Seventh Circuit, anticipation of immediate proceedings in bankruptcy was the compelling motive for retaining and paying the attorney. Conversely, it would appear that if such were not the impelling motive, the Court would not have had jurisdiction.

POINT III.

The provisions of Section 60 (d) and Section 64 (b) (3) are correlative and are intended to protect attorneys in the payment of fees in connection with bankruptcy proceedings for services rendered which are pertinent to the aims of the Bankruptcy Act as well as to protect creditors against the payment by the bankrupt, in advance of the filing of the petition, of excessive fees for services with respect to which the bankruptcy court should alone have jurisdiction.

It was early pointed out that by reading together the provisions of Sections 60 (d) and 64 (b) (3) of the Bankruptcy Act, a logical arrangement is worked out for the compensation of attorneys who assist the bankrupt in rendering those services which are required of him by the Bankruptcy Act. Section 64 (b) (3) extends priority, as part of the cost of administration, to fees "for professional services actually rendered * * * to the bankrupt in involuntary cases while performing the duties herein prescribed."

Under the latter section, provision is made for payment to attorneys who have rendered services within the purview of the Bankruptcy Act out of the estate itself. Section 60 (d) has been construed as protecting attorneys who may have received payment in advance of the filing of a petition in bankruptcy, to the extent that such payment so made shall not be deemed preferential. In order that the Court may not be limited in its right to fix compensation, and in order to prevent a person about to become a bankrupt from arrogating to himself the right of the Court to fix compensation for such services, provision is made for a re-examination of the fees so paid.

It has accordingly been repeatedly held that the provisions of Section 60 (d) have no relation whatsoever to serv-

ices other than those "germane to the aims and purposes of the Bankruptcy Act" and that compensation paid to attorneys for other purposes are not subject to re-examination under that Section.

In an early case, *In re Kross*, 96 Fed. 816 (D. C. N. Y.), Judge BROWN said (p. 819):

> "Section 64 speaks only of an attorney's fees; while Section 60, subd. d, uses the word 'counselor' also. The services contemplated by both are doubtless for the most part those of an attorney only, as distinguished from the services of 'counsel.' They include the preparation of the necessary legal papers, procuring the adjudication and reference, bringing the debtor before the referee for such subsequent proceedings as may be required, making in due time the application for discharge, attendance before the judge and referee, as may be needful, and throughout the proceedings keeping himself informed of their progress and giving such attention to the essential steps in the bankrupt's behalf as will secure to him a regular and valid discharge. These are the ordinary attorney's duties."

Construing the provisions of Section 64 (b), the Court said (p. 818):

> "This clause of paragraph 3, therefore, indicates the general nature of the services for which a fee is designated to be allowed, viz: those professional services which presumably are necessary and indispensable to the bankrupt to enable him to perform the duties required of him by the act for the benefit of creditors on the one hand, or to secure his own correlative right to discharge on the other."

Again referring to Sections 60 (d) and 64 (b) he said (p. 818):

> "The charges to be 'approved' are, I cannot doubt, for the same services which the 'fee' is designed to be

> allowed for under Section 64, subd. b, par. 3. Both paragraphs are to be construed, together, so that it becomes immaterial in the result whether the attorney obtains his compensation in the first instance from the bankrupt under Section 60, refunding what, if anything, is disallowed by the court, or whether he waits for an allowance by the court under Section 64."

The theory of the *Kross* case, which limits the application of Section 60 (d) to those cases in which services rendered were pertinent to the purposes of the Bankruptcy Act, has been repeatedly applied in other cases in various Circuits. In *In re Stolp,* 199 Fed. 488 (D. C. E. D. Wisc.), the Court reviewed the authorities and came to a conclusion similar to that of Judge BROWN. The Court said (p. 495):

> "The general conclusions are that Section 60 refers to the services to be rendered after the time of the payment or transfer; *that such services must be germane to the general aims of the Bankruptcy Act;* that they must be actually rendered, if at all, before the institution of bankruptcy proceedings, and that the payment or transfer specified in said section cannot apply to services rendered as specified in Section 64b; that Section 64b refers to services rendered after the bankruptcy proceedings are instituted, to aid the bankrupt in performing his duties under the act."

Commenting on the case of *In re Habegger,* 139 Fed. 623 (C. C. A., 8th Circ.), the Court said, in the *Stolp* case:

> "The question as to the character of the services contemplated was directly involved in *In re Habegger* (C. C. A., 8th Circ.), 15 A. B. R. 198, 139 Fed. 623, and it was determined that they were such as were to be rendered in aid of the purpose sought to be accomplished by the Bankruptcy Act, to conserve and benefit the estate of the bankrupt, and therefore inure to the benefit of creditors; and accordingly a payment or

> transfer from a failing debtor for services to be rendered in endeavoring to get a composition with creditors, and in defending the failing debtor in a criminal prosecution, was not within the terms of this section."

The Court adopted the rule in the *Habegger* case and said:

> "I am aware that this restricted view will also affect the application of the remedy provided in Section 60d strictly to such cases as appear to be payments for services to be rendered, when such services are admitted or adjudicated to be of the character specified, namely, services germane to the purposes of the Bankruptcy Act; and when it appears that the service to be rendered was not of such a character, the right to review cannot be exercised, but the transaction must either stand or be attacked under some other provision of the Bankruptcy Act."

Similarly in *Quinn* v. *Union National Bank,* 32 Fed. (2nd) 762 (C. C. A., 8th Circ.), KENYON, *C. J.,* said (p. 765):

> "It is the purpose of Section 60d of the Bankruptcy Act to permit a party to secure the services of attorneys to be rendered in connection with the bankruptcy proceedings, and said subdivision d relates to services germane to the bankruptcy proceedings * * * The test laid down by Judge Adams in *Re Rosenthal and Lehman* (D. C.), 120 F. 848, is whether or not the services are rendered in good faith for the purpose of administering the act in a way to carry out the purpose of its enactment."

The Circuit Court of Appeals in the Second Circuit, in an earlier case, had come to a similar conclusion with respect to the scope of Section 60 (d). In *In re Rolnick,* 294 Fed. 817, the Court said (p. 819):

> "The act recognizes the right of the debtor to have the aid and advice of counsel, and to make provisions

> for a reasonable compensation to his counsel for *services which are germane to the aims of the Bankruptcy Act,* subject, however, to the right of the Court, if the Trustee or any creditor questions the transaction, to re-examine it, with a view to determining the reasonableness of the amount paid. *In re Wood*, 210 U. S. 246. *But the services to be rendered, we think, must be germane to the aims of the Bankruptcy Act and they must be rendered prior to the institution of the bankruptcy proceedings to make Section 60d applicable."* (Italics ours.)

In the present case the learned Circuit Court of Appeals apparently held that the fees paid to an attorney are subject to re-examination regardless of the nature of the services which the attorney was engaged to perform.

It was our contention to the learned Circuit Court of Appeals that if, properly construed, Section 60 (d) does not permit allowance for services not germane to the purposes of the Bankruptcy Act, it must be similarly held that payments made to attorneys for services of a different nature are not subject to re-examination. The learned Court held that such contention is a *non sequitur.* The Court, in its opinion, stated (Record, p. 52):

> "The premise is that, as to services in no way beneficial to the estate or connected with the duties of a bankrupt, no compensation is allowable. The conclusion need not be, as the appellants urge, that none of the retainer is recoverable by the trustee under section 60d; rather it may be that the whole of it is recoverable, as *In re Habegger* seems actually to have held."

The effect of the Court's determination must accordingly be that all fees paid, for whatever services rendered, where bankruptcy is contemplated by the client, are subject to re-examination, even though not subject to any allowance

whatsoever. Such construction, we respectfully urged, could not have been contemplated by Congress. Thus, valuable services might be rendered by an attorney in good faith wholly apart from proceedings in bankruptcy and yet moneys paid to such attorney, however reasonable in amount, would, under the theory of the learned Circuit Court of Appeals, be subject to summary review and refund in the event that bankruptcy subsequently occurred.

POINT IV.

Our contentions are consistent with the decisions of this Court and the determination of the Circuit Court of Appeals is inconsistent with those decisions and with the decisions in other circuits.

In *Randolph* v. *Scruggs,* 190 U. S. 533, Mr. Justice HOLMES, in discussing the extent to which an attorney was entitled to priority of payment out of a bankrupt estate for services rendered to the bankrupt and to his assignee for the benefit of creditors, said:

> "We are not prepared to go further than to allow compensation for services which are beneficial to the estate."

In *In re Wood and Henderson,* 210 U. S. 246 (quoted *supra*) this Court again held in construing Section 60 (d) that it provided for the payment of a fair compensation to an attorney engaged by the bankrupt in contemplation of the filing of a petition in bankruptcy.

So far as we are able to ascertain, this Court has not passed upon the question whether the proper construction of Section 60 (d) with respect to jurisdiction to re-examine limits such jurisdiction to cases as involve services which, under the *Randolph* case, are subject to compensation. To

hold, as the learned Court below did, that while not subject to compensation, services not directly beneficial to the estate are, nevertheless subject to re-examination, would create a situation involving an extremely inequitable state of affairs. If the Court's jurisdiction to re-examine is broader than the Court's authority to make allowances for services rendered, an attorney would be deprived of even fair compensation for services rendered in good faith in connection with matters not pertinent to the bankruptcy proceedings.

Under the rule in the *Randolph* case, the Bankruptcy Court cannot extend priority or allow compensation to an attorney except for services which are beneficial to the estate and only to the extent of the benefit derived by the estate. Thus a standard is prescribed by which the value of an attorney's services is to be measured in a court of bankruptcy. If, as a number of cases hold, Section 60 (d) is to be construed as supplementing Section 64 (b) (3), and as so construed is to be limited in its application to services "germane to the purposes of the Bankruptcy Act," a logical method for the payment of attorneys' services in connection with bankruptcy proceedings is created. If, however, the decision of the Circuit Court of Appeals is correct, all services rendered are subject to re-examination and then, applying the yard-stick prescribed by this Court, allowance is to be made only to the extent that such services are beneficial to the estate. In many cases, as the Court below suggests, no compensation whatsoever could be allowed.

Our present contention is that under Section 60 (d) payments made for legal services to conserve the estate or to aid the bankrupt in performing the duties devolving upon him under the Bankruptcy Act, and the like, are subject to re-examination; that in such case the true measure of value is that applied in the *Randolph* and *Wood* cases, *supra*, i. e., the benefits derived either in assisting in the administration of the estate or in conserving its assets; that to such extent

payments made, even in the knowledge of the client's condition, are protected against attack as preferences; that all other payments for services rendered are neither protected from such attack nor subject to summary review; that in such other cases, if the payment is made without adequate consideration or is received after the rendition of the services with knowledge of its preferential character, such payment is subject to attack only in an action to set aside a fraudulent payment or transfer.

Such construction is consistent with the general principles of the Bankruptcy Act. It avoids the singling out of attorneys as being subject to such discriminatory provisions. Certainly a doctor, dentist or accountant who may have received substantial fees on the very eve of bankruptcy is not subject to summary process under Section 60 (d). The construction for which we contend avoids the manifestly unfair and unjust rule under which the yard-stick by which the value of the services is determined is the benefit to the estate.

Concededly, the services rendered by petitioners, however valuable they might have been to the client, were of little value to the bankrupt estate. As a matter of fact the filing of the petition in bankruptcy destroyed the value which petitioners' work had built up. To say that the value of such services must be measured according to the rule indicated in the opinion of the Court below is, in effect, to deprive petitioners of any fair compensation for services rendered, in good faith, in a lawful, proper and wholly laudable effort of the client to reorganize its business and keep it a going concern.

Logic and reason militate against the construction adopted by the Court below.

Freedom of contract applies to attorneys' services as to all others, in the absence of express statutory prohibition. Neither the client nor the attorney in this case could foresee future events. According to the books of the corporation

it was solvent even though unable to liquify its frozen assets to avoid embarrassment. It is not questioned that petitioners were retained by the corporation in the honest belief that the services rendered by them would be of substantial benefit to the corporation and that the appellants did, in good faith, render substantial services which, had a petition in bankruptcy not been filed, would have been instrumental in saving the corporation's business and also in conserving the creditors' rights. A summary re-examination of the payment made for such services is, we submit, inequitable and without legal justification. This is especially true where the measure of compensation to be applied is wholly different from that which would ordinarily prevail between attorney and client.

Our contentions, if sound, do not foreclose the trustee from proper proceedings in which the good faith of petitioners may be questioned. If there is even a suggestion that petitioners acted other than in good faith the trustee may, by proper proceedings, attack the payment and secure proper remedy.

V.

The decree appealed from should be reversed and the proceedings remitted to the Court below with appropriate directions to dismiss the petition of the trustee.

Respectfully submitted,

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